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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

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Chairman
Jim Irvin
Commissioner
William A. Mundell
Commissioner
Mike Gleason
Commissioner
Jeff Hatch-Miller
Commissioner

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ARIZONA CORPORATION COMMISSION
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Arizona Corporation Commission

DOCKETED

JUN 18 2003

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IN THE MATTER OF THE APPLICATION OF
ARIZONA WATER COMPANY, AN
ARIZONA CORPORATION, FOR ADJUST-
MENTS TO ITS RATES AND CHARGES FOR
UTILITY SERVICE FURNISHED BY ITS
NORTHERN GROUP AND FOR CERTAIN
RELATED APPROVALS.

DOCKET NO.

W-01445A-00-0962

NOTICE OF FILING

Pursuant to the Procedural Order issued April 25, 2003, the
ARIZONA UTILITY INVESTORS ASSOCIATION, INC. (AUIA) hereby
submits the direct testimony of Walter W. Meek. Respectfully
submitted this 18th day of June, 2003.

Walter W. Meek, President

CERTIFICATE OF SERVICE

An original and 13 copies of the referenced
testimony were filed this 18th day of June,
2003, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Copies of the referenced testimony were delivered this 18th day of June, 2003, to:

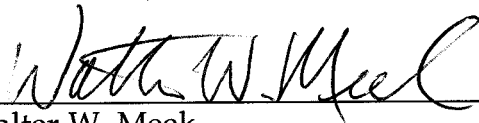
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Copies of the referenced testimony were mailed this 18th day of June, 2003, to:

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Walter W. Meek

1 DIRECT TESTIMONY

2 OF

3 WALTER W. MEEK
4
5
6
7

8 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

9 A. My name is Walter W. Meek. My business address is 2100 North Central
10 Avenue, Suite 210, Phoenix, Arizona 85004.
11

12 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

13 A. I am the president of the Arizona Utility Investors Association ("AUIA"
14 or "Association"), a non-profit organization formed to represent the
15 interests of equity owners and bondholders who are invested in utility
16 companies that are based in or do business in the state of Arizona.
17

18 Q. DOES THE AUIA MEMBERSHIP INCLUDE THE OWNERS AND
19 OPERATORS OF ARIZONA WATER COMPANIES?

20 A. Yes. AUIA's members include large Class A water companies and
21 smaller Class B and C water companies. In addition, AUIA is an
22 associate member of the Water Utilities association of Arizona and three
23 of the members of the AUIA board of directors are from the water
24 industry.
25

26 Q. HAS AUIA BEEN GRANTED INTERVENTION IN THIS
27 PROCEEDING?

28 A. Yes. AUIA was a late-filed intervenor.
29

30 Q. HAVE YOU FILED TESTIMONY PREVIOUSLY IN THIS MATTER?

31 A. No. We did not participate in the Arizona Water Company's northern
32 division rate case. We chose to intervene only in the portion related to
33 arsenic cost recovery after the Commission's April 22 open meeting.
34

1 Q WHAT IS AUIA'S INTEREST IN THESE ISSUES?

2 A. AUIA has been involved intermittently in the arsenic issue since the 10-
3 parts-per-billion (ppb) limitation was proposed by the Environmental
4 Protection Agency in the Clinton Administration. We joined with other
5 parties in Arizona, New Mexico and California in urging that the rule be
6 re-examined when the national administration changed hands.
7

8 Q. HAS AUIA CONTINUED TO BE INVOLVED IN THIS ISSUE?

9 A. Yes. After the Bush Administration affirmed the 10 ppb limit, AUIA
10 joined an ad hoc task force of Arizona stakeholders who attempted to lay
11 the groundwork for expedited recovery of arsenic treatment costs. The
12 task force included the Arizona Department of Environmental Quality
13 (ADEQ), the Water Infrastructure Financing Agency (WIFA), RUCO and
14 Commission Staff, among others.
15

16 Q. WHAT WAS AUIA'S CHIEF CONCERN?

17 A. From the birth of the 10 ppb proposal, we have been apprehensive that
18 compliance with the standard would impose a significant and perhaps
19 unmanageable financial burden on private Arizona water companies.
20 We have also been concerned that the Commission would find it
21 difficult to produce a cost recovery mechanism that would compensate
22 water companies fully and on a timely basis.
23

24 Q. WHAT ISSUES DOES YOUR TESTIMONY ADDRESS?

25 A. I will discuss only two issues: the recovery of O & M costs within the
26 Arsenic Cost Recovery Mechanism (ACRM) and the treatment of leasing
27 costs. However, I would like to offer a clarification at the outset.
28

29 Q. WHAT IS THE CLARIFICATION?

30 A. AUIA asserted in its application for intervention that it would not
31 reopen issues that have already been litigated in this case. The
32 recommended opinion and order, which is pending, asserts that O&M

1 will not be recoverable under the ACRM and it is RUCO's position that
2 O&M is a closed issue. However, based on representations made at
3 recent settlement meetings, Staff is clearly willing to reconsider that
4 issue on a limited basis and AUIA is responding.
5

6 Q. HAVE THE POSITIONS OF THE PARTIES CHANGED REGARDING
7 O&M?

8 A. To some degree, yes. To put it in context, I should point out that the
9 company, in settlement discussions, divided arsenic mitigation into two
10 scenarios for its Sedona system. One was a construction scenario, in
11 which AWC would build, own and operate the required arsenic
12 treatment facilities. In the second scenario, a lessor would build and
13 operate the facilities for a fixed lease payment over four years.
14

15 Q. HOW WAS O&M TREATED IN THE FIRST SCENARIO?

16 A. In the context of the construction scenario, the company proposed that
17 three specific costs devoted entirely to arsenic treatment be recoverable
18 as a part of the ACRM. Those costs were identified as 1) media
19 replacement costs, 2) replacement service costs, and 3) waste media
20 disposal costs.
21

22 Q. HOW DID THE OTHER PARTIES REACT TO THIS PROPOSAL?

23 A. In its counter proposal of June 9, Staff accepted the notion of including
24 these specific cost elements in the ACRM, classifying them as "Approved
25 O&M Recovery." I believe RUCO continues to oppose the inclusion of
26 any O&M in the ACRM.
27

28 Q. DOES AUIA HAVE A POSITION ON THIS PROPOSAL?

29 A. Yes. AUIA supports the inclusion of these costs in the ACRM for the
30 following reasons:

- 31 • These expenses are clearly identifiable and easily tracked without audit
32 complications.

- 1 • They represent a pure pass-through, with no overhead charges.
- 2 • Early recovery of these specific costs create no threat that AWC will
- 3 over-earn as a result.
- 4 • Recovery will mitigate the ongoing impact of O&M costs, which in
- 5 many arsenic treatment regimens may be as burdensome to the water
- 6 company as the capital outlays for facilities.
- 7 In short, this proposal would go a long way toward meeting the
- 8 Commission's objective of reducing the financial burden of arsenic
- 9 treatment without undermining rate-of-return regulation.

10

11 Q. PLEASE EXPLAIN THE LEASING SCENARIO.

12 A. It should be noted that AWC acquired actual bids from vendors for a

13 specific treatment option under both the construction and leasing

14 scenarios. The fixed-price leasing offer included all costs over the four-

15 year lease period except property taxes. In other words, all O&M was

16 included in the proposed lease payment.

17

18 Q. IS THERE A SIGNIFICANT DIFFERENCE IN COST TO THE

19 RATEPAYER BETWEEN THESE PROPOSALS?

20 A. Yes. According to the information provided by AWC, the annual

21 revenue needed to support the lease scenario is 34 percent less than the

22 revenue requirement for the construction scenario.

23

24 Q. HOW DID THE PARTIES REACT TO THE LEASE SCENARIO?

25 A. I believe RUCO continues to oppose recovery of O&M, even if it is

26 buried in an all-inclusive lease. The Staff position, as I understand it, is

27 that the lease should be broken down so that O&M costs can be separated

28 into components that are recoverable and those that are not. In that

29 way, Staff proposes to put construction and leasing on equal footing.

30

31 Q. IS THAT POSSIBLE?

1 A. The concept escapes me. It may be possible to put the O&M components
2 on a comparable basis, but the economics of a leased facility will usually
3 be based on very different parameters from the traditional construction
4 and amortization cycle of a regulated utility.
5
6 Q. ARE THERE PROBLEMS WITH THE STAFF'S APPROACH TO
7 LEASING?
8 A. There may be. In this case, AWC has said they are not sure that the
9 lessor would consent to dissecting the lease to expose the O&M and
10 capital components. The company contends that the lease should be
11 treated as an all-inclusive transaction in which the entire cost of the
12 lease would be recoverable through the ACRM.
13
14 Q. WHAT IS AUIA'S POSITION?
15 A. Our overall position is that the Commission should not impose any
16 unnecessary conditions that would preclude leasing arsenic treatment
17 facilities, not only for AWC, but also for any other water companies. It is
18 unclear to AUIA what will be accomplished by dissecting the lease. If the
19 system meets EPA and ADEQ specifications and if the lease is less costly
20 to ratepayers, then the cost components should be irrelevant.
21
22 Q. HOW WOULD A LEASE AFFECT THE COMPANY'S EARNINGS?
23 A. It wouldn't have any effect. Like the Staff's "Approved O&M Recovery,"
24 the lease cost is a pure pass-through, with no company overhead
25 included and no rate-of-return or earnings implications.
26
27 Q. BESIDES COST, WHAT ARE SOME ADVANTAGES TO LEASING?
28 A. AUIA has identified at least two.
29 First, at this point in time, the company and its customers may benefit
30 substantially from not becoming locked into a specific treatment
31 technology, which could become obsolete in a few years.

1 Second, small water companies may not be able to raise capital for
2 treatment facilities, especially if they are unable to recover O&M costs on
3 a timely basis. If leasing is not restricted, it could be the best or only
4 solution for financially strapped water companies.
5

6 Q. UNDER AWC'S LEASING SCENARIO, WHAT WOULD HAPPEN AT
7 THE END OF THE LEASE PERIOD?

8 A. The company could have various options, which could include
9 renewing the existing lease for a longer or shorter period or building or
10 leasing new facilities utilizing different technology.
11

12 Q. ARE YOU CONCERNED THAT AWC COULD BE LEFT "HOLDING THE
13 BAG" WHEN THE LEASE EXPIRES?

14 A. I don't see how that could happen. Their options four years down the
15 road would be no worse than they are today and they would have the
16 benefit of operating experience they don't have now. In the meantime,
17 AWC would have met its obligations to meet the arsenic standard and
18 would have saved some money for its customers.
19

20 Q. DO YOU HAVE ANY CONCLUDING REMARKS?

21 A. Yes. The major unresolved issue between the company and
22 Commission Staff is the treatment of lease costs – whether the cost of a
23 lease can be recovered fully under the ACRM. AUIA believes that the
24 Staff's and RUCO's preoccupation with O&M costs may threaten the
25 leasing scenario as a viable solution to arsenic compliance, not only for
26 AWC but for many other water providers under the Commission's
27 jurisdiction. Unless the Staff can support its anxiety with verifiable risk
28 factors, the Commission should accept leasing as a recoverable expense.
29 Otherwise, the Commission will deny ratepayers the least-cost option.
30

31 Q. IS THAT THE END OF YOUR TESTIMONY?

32 A. Yes, it is.